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SUBJECT: ANATEL COUNTERS SPECULATION ON TELECOM MERGER

REFS: (A) BRASILIA 59,(B) BRASILIA 38,(C) 03 BRASILIA 3405

1. A barrage of Brazilian press articles have speculated that President Lula dismissed National Telecommunications Agency (ANATEL) President Schymura in large part due to the latter's insistence that Brazil's three regional fixed-line local telephone service giants be blocked from buying Embratel, the long-distance carrier being sold by MCI (Ref B). The last such article appeared in the January 28 addition of daily 'O Globo', which speculated that Telemar, Telefonica, and Brazil Telecom would now be allowed to buy Embratel, extending their local monopoly into the long-distance market and thereby squelching foreign investment. Attorneys and an engineer from ANATEL's competition division categorically denied such press speculation during a January 28 meeting with Econoff and asserted that the proposed Embratel purchase is illegal under current law.

2. Jose Goncalves Neto, General Manager of Competition, an engineer who has been with ANATEL since its 1997 formation, commented that, despite all of the conjecture, the merger as proposed is contrary to Brazilian law and could not occur without congressional approval of a change in the law. He predicted such a change would be unlikely. The ANATEL competition specialists have recommended breaking Embratel into two separate companies; one regulated company of telephonic services, and an unregulated company which would consist of Internet services.

3. Neto added that ANATEL was patterned from the U.S. Federal Communications Commission and that it looks to the U.S. model for inspiration. The FCC does not have a role in Internet regulation, and ANATEL would like to discontinue regulation of these services. Naturally, the move would also open more competition to vie for the two newly created companies, since the value of the two entities would be less than the current valuation of Embratel.

4. Neto debunked press reports that Schymura's public opposition to the fixed-line carriers' bid for Embratel was the main driver behind his being forced out as president of ANATEL. Neto opined that the issue was only a minor part of Schymura's problems, citing political factors as the main contributors. These factors included Lula's desire to recompense Communication Minister Miro Teixeira for his removal as minister by placing Teixeira's close ally Ziller in the ANATEL presidency, as well as the Minister's vehement disagreement with ANATEL's tariff increase in 2003 (Teixeira encouraged the consumer's lawsuit against ANATEL to roll back the tariff increase), what the Ministry perceived as slow movement on regulatory decisions, and the worrisome exit of some foreign investors (U.S. corporations divesting from Brazil's telecom sector since privatization in 1996 include ATT, BellSouth, QUALCOMM, as well as MCI's stated intention to sell Embratel).

5. Comment: It would seem ironic that Neto's list of Schymura's shortcomings included concern over foreign divestment, given the uncertainty over the stability of the regulatory regimes that the GoB's own actions -- including the Schymura firing--have generated (Ref C). Ziller's appointment, to the extent that it smoothes the working relationship between the Ministry and ANATEL, could reduce bureaucratic tension and uncertainty, but he has not yet